

Fed Adopts Final Rule Regarding Contract Termination Provisions for Repos, Stock Loans and Swaps with Systemically Important Banks

September 8, 2017

On September 1, 2017 the Federal Reserve voted to adopt a final rule requiring U.S. global systemically important banking institutions ("GSIBs") and the U.S. operations of foreign GSIBs to amend qualified financial contracts ("QFC") to limit counterparty termination rights that may arise from the failure of a GSIB or its affiliates. The rule is intended to facilitate the orderly resolution of a GSIB by limiting the ability of a firm's counterparties to immediately terminate QFCs upon the commencement of a bankruptcy or another resolution process.

The final rule, which was first proposed in 2016, contains two primary provisions. First, it requires the inclusion of contractual restrictions on the exercise of default rights (including a stay period after the commencement of a receivership, insolvency, liquidation, resolution, or similar proceeding). Second, it generally prohibits QFCs from containing cross-default rights against the GSIB and its affiliates.

QFCs include derivatives contracts, repurchase agreements and securities lending and borrowing agreements. In adopting the Final Rule, the Fed noted that due to the large volume of QFCs to which GSIBs are a party, the mass termination of QFCs in the event of financial distress or failure of a GSIB could lead to the disorderly failure of the firm and spread contagion by increasing volatility and lowering the value of similar assets held by other firms.

There are currently eight U.S. GSIBs: Bank of America Corp., Bank of New York Mellon Corp., Citigroup Inc., Goldman Sachs Group Inc., JPMorgan Chase & Co., Morgan Stanley, State Street Corp. and Wells Fargo & Co. There are another 22 foreign GSIBs, 20 of which have U.S. operations and are therefore covered by the final rule.

The final rule will go into effect 60 days after it is published in the Federal Register, and compliance will be phased in over a period of two years. GSIBs may also comply with the final rule by adhering to the ISDA 2015 Universal Resolution Stay Protocol.